January 16, 2001

To Members of the General Assembly:

This Annual Report is presented to assist you with a general overview of the State's financial condition in the particular areas of debt, investments and cash management, as well as other matters within the purview of the State Treasurer's Office. A general understanding of these issues will also assist the committees to examine the appropriations to the Treasurer's Office operating budgets as well as the appropriations for debt management.

The Appropriations and Institutions Committees, in cooperation with the Administration and this office, have been active partners in returning Vermont to fiscal stability and to a course of reducing the high debt burdens that the State had accumulated.

In recent years we began to trend down new authorizations of long-term debt to overcome Wall Street rating agency concerns. Consequently, the State has reduced its new authorizations in this decade from $83.4 million in FY '91 to $34 million in FY '01. As a result of this policy, the State's total debt decreased over the last four years from $536.2 million as of June 30, 1997 to $503.8 million as of June 30, 2000, a decline of 6.0%. Also more expensive financing mechanisms employed in the past, such as long-term capital lease obligations and certificates of participation, were refinanced with lower cost general obligation bonds. Total debt service - the amount appropriated to pay principal and interest on bonds - remained at approximately the same level as fiscal year 2000 at $75 million.

In October 1998, Standard & Poor's upgraded Vermont's rating from AA- to AA. In the fall of 1999, Moody's Investors Service upgraded the State's rating from Aa2 to Aa1 and Fitch IBCA upgraded the State from AA to AA+. In September 2000, Standard & Poor's upgraded the State's rating for the second time in two years to AA+. All three rating agencies recognized many improvements in Vermont's fiscal policies, financial management operations, debt burden, and uncomplicated debt management systems.

The FY '01 Capital Bill authorized $34 million in long-term debt. The General Assembly reduced that authorization by $10 million in appropriations from surplus cash at fiscal year-end. The State has not yet marketed the remaining $24 million in authorized bonds because the Administration has proposed funding the 2001 capital projects with cash instead of bond proceeds. The attached report discusses the impact the Administration's proposal would have on the State's debt position and key debt indicators significant to the rating agencies.

As we prepare for fiscal year 2002, the Capital Debt Affordability Advisory Committee recommends that the State authorize new long-term debt in the amount of $39 million. This recommendation is consistent with the Committee's goal of maintaining a yearly issuance of $39 million into the foreseeable future because of the positive impact this level of debt issuance will have on the key debt indicators monitored by the Committee.

The State Treasurer is responsible for investment of the state's cash. The State's short-term portfolio earned over $11 million in interest income in fiscal year 2000, a yield of 5.53%, on an average daily balance of $197 million. This yield again exceeded the average return on the three-month treasury bill auction rate. The excellent yield on the State's short-term investments is attributable, in part, to the short-term investment program instituted by this office. Daily offerings are solicited from the institutional trading desks of dozens of national and local brokers in order to achieve the maximum rate of return and diversification in the portfolio.

The Abandoned Property Division of the State Treasurer's Office was again ranked first in the nation in its rate of return of unclaimed property to its rightful owners. More than $12 million in unclaimed property is currently held by the State. Over $2.2 million in unclaimed property was turned over to the State in fiscal year 2000 and nearly $2.4 million in claims were paid in the same year.

I look forward to working with the General Assembly to attain our shared goal of continued fiscal stability for the State of Vermont.

Sincerely,

James H. Douglas
State Treasurer

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I. DEBT MANAGEMENT

A. THE POLICY OF "TRENDING DOWNWARD" LONG AND SHORT-TERM DEBT AND THE RESULT

Since fiscal year 1995, the State Treasurer's Office, in conjunction with the Administration, has set a course to trend down new authorizations of long-term debt to overcome concerns of the major Wall Street rating agencies. Consequently, the State has reduced its new authorizations from $73.7 million in FY '93 to $34 million in FY '01. (See Chart 1.)

By lowering new authorizations the State of Vermont has begun to reduce its total level of outstanding long-term debt. The State's total debt decreased from $517.2 million as of June 30, 1999 to $503.8 million as of June 30, 2000, a decline of 2.6%. Also more expensive financing mechanisms employed in the past, such as long-term capital lease obligations and certificates of participation, have been refinanced with lower cost general obligation bonds. (See Chart 2.)

Total debt service – the amount appropriated to pay principal and interest on bonds – for fiscal year 2001 decreased by 1.5% to $74.9 million, compared to $76.0 million in fiscal year 2000. This decline comes after a 4.9% increase in FY '00. That increase was due primarily to $2.4 million in debt service payments that resulted from the maturity of the 1993 Series C Capital Appreciation Bonds (CABs) and the inclusion of debt service on a capital lease for transportation equipment that year. Neither event was repeated in FY '01. Future debt service payments will continue to fluctuate over the next decade and are not expected to show any steady decrease until final payments of CABs in 2011. (See Chart 3.)

The State continues its work to reduce key indicators monitored by the rating agencies, and an important ratio is showing improvement. On an absolute basis, the State's ratio of debt as a percentage of personal income improved dramatically from 1997 to 1998. The drop from 4.7% to 4.2% represented the largest improvement and lowest level for this ratio since 1991. The State matched this ratio in fiscal year 1999. In FY '00, the ratio dropped from 4.2% to

3.8%, the lowest level since 1990. The State's ranking in its debt per capita ratio, however, remained the same as in 1999 at 10th highest among the states.

Similarly, the State has made great strides in the area of short-term debt. In fiscal year 1999, for the first time in a decade and only the third time in 30 years, the State's strong cash position did not require the issuance of short-term debt. Again, in FY '00, no short-term debt was incurred. In the early 1990's, Vermont was issuing between $155 and $192 million annually, not including $65 million in deficit notes. (See Chart 4.) On numerous occasions the rating agencies expressed concern about why the State's cash flow position necessitated such high levels of short-term borrowing. This reduction in the need for short-term debt has been cited by all three agencies as a significant factor in their recent upgrades of the State's ratings. Besides the positive view held by the rating agencies, the State has saved significant money by avoiding interest charges on borrowed dollars as reflected in Chart 5. No short-term borrowing is anticipated for FY '01.

B. LONG-TERM DEBT

1. The State's Ratings

In a one year period, each of the three major credit rating agencies upgraded the State's General Obligation bond rating. In September 1999, Moody's upgraded the State's rating from Aa2 to Aa1. In October 1999, Fitch IBCA upgraded the State from AA to AA+. In September 2000, Standard & Poor's upgraded the State's AA rating to a AA+. This was the second upgrade by S&P in two years, as its previous upgrade from AA- to AA occurred in October 1998.

Each rating agency cited several positive factors that were taken into consideration in the upgrades, including the following:

- Sound fiscal policies that have been consistently followed with conservative revenue estimates and moderate growth in spending limits
- Strong financial performance with fully funded budget stabilization reserves

- An uncomplicated debt management system with a nearly exclusive use of general obligation debt
- A moderate and manageable debt burden that is declining due to rapid amortization schedules and reductions in the State's debt issuance, as well as the elimination of short-term borrowing
- Successful implementation of school finance reform
- Elimination of a $117 million contingent liability of the Vermont Home Mortgage Guarantee Board
- Strong capital planning that concentrates on using surpluses for capital and reducing future debt service costs

Whenever the State of Vermont enjoys a higher rating it enhances the marketing of its long-term debt and should result in lower interest rates that the State pays to borrow money.

2. General Obligation Debt

In 1999, the Capital Debt Affordability Advisory Committee recommended a policy of maintaining a yearly issuance of $39 million of new debt into the foreseeable future because that level will have positive effects on key debt ratios monitored by the Committee. For FY '00, the State issued $37 million in General Obligation bonds, which represented a $39 million authorization less $2 million of surplus allocated to the reduction of authorized debt.

The Debt Affordability Committee recommended only $34 million in authorized debt for fiscal year 2001. Because the 1999 Legislature authorized the Agency of Transportation to enter into capital leases of up to $5 million, the Committee recommended only $34 million in additional debt. The reason for the lower recommendation was to compensate for the lease authorization which is reportable as long-term debt. The $5 million lease-purchase authorization was repealed by the Legislature during the 2000 session and cash was appropriated.

The $34 million authorization was further reduced by the Legislature when it appropriated another $10 million in surplus cash in the FY ’01 Appropriations Act. An appropriation of $4 million was made “to reduce authorized but unissued general obligation bonds” and another $6 million, if available, was appropriated “to reduce authorized but unissued general obligation debt and avoid debt issuance during fiscal year 2001.” The entire $10 million was available at fiscal year end and $24 million in authorized general obligation debt remains unissued.

Under normal circumstances, $24 million of bonds would have been issued by the State in the fall of 2000. The Administration has recommended, however, that the remaining $24 million needed to fund capital projects in the FY ’01 Capital Bill also be funded with cash. The State did not go to market this fall pending this Legislature’s consideration of the Administration’s proposal to forego issuance of any debt in FY ’01.

If no debt is issued in FY ’01, and $39 million is issued annually between FY ’02 and FY ’11, the State’s debt service would decrease from the 2001 level of $74.9 million to $73.8 million in 2011. Debt outstanding would decline at an average annual rate of 2.3%, from $503.8 million as of June 30, 2000 to $392.1 million as of June 30, 2011.

If the State were to issue bonds in FY ’01 to fund the remaining $24 million needed for capital projects, and issued $39 million annually between FY ’02 and FY ’11, the State’s debt service would remain at roughly $75 million in 2011. Debt outstanding would decline at an average annual rate of 2.0% from $503.8 million as of June 30, 2000 to $403.4 million as of June 30, 2011.

One of the key debt factors monitored by the Debt Affordability Advisory Committee is the ratio of the State’s general obligation debt per capita. The guideline followed by the State established an acceptable ratio of debt per capita at an inflation adjusted target of $788 ($700 in 1995 dollars adjusted for inflation) while the State’s debt per capita ratio as of June 30, 2000 was $848. By issuing $24 million in FY ’01 and continuing a steady level of authorization of $39 million in future years and employing the population forecast developed by Economic Policy Resources, the State is forecast to achieve a ratio of $777 in 2003, a level lower than the targeted debt per capita goal of $808 for that year. If no bonds are issued in FY '01 and a $39 million annual issuance is authorized thereafter, the State would reach its debt per capita target ratio in 2002.

The next significant key debt ratio, debt as a percentage of personal income, dropped from its 1999 ratio of 4.2% to 3.8% in FY '00. The State's guideline for this ratio is that "aggregate projected State debt should not exceed five percent of projected State personal income in the next ten years." After nearing the 5% threshold in 1996, the current ratio is at 3.7% reflecting steady improvement in this category. If $24 million in General Obligation bonds is issued in FY '01 and $39 million issue each year thereafter, improvement should continue and the State would equal the five-year Moody's median (2.1%) in 2008. If no bonds are issued this year, the median would be reached in 2007.

The State remained in compliance in FY '00 with its established guideline with respect to a third key debt ratio – debt service as a percentage of revenues. The guideline used for this ratio states that projected annual State debt service on bonds should not be in excess of eight percent of projected revenues in the aggregate General and Transportation Funds during the next ten years. The current debt service as a percentage of revenues ratio, computed recently by the State's financial advisor to be at 7%, is well below the 8% guideline. If $24 million in bonds is issued in FY '01, and $39 million in future years, the ratio is forecast to decline to 6.5% in 2002. The ratio would decrease to 6.2% in 2002 if no bonds are issued this year.

At the Administration's request, the Capital Debt Affordability Advisory Committee reviewed and commented on the Administration's proposal at its annual meeting in September, 2000. The Committee's comments recognized that the elimination of debt issuance for a year would send a "striking message" reflecting Vermont's "strong desire to cut further into its debt level" and would allow the State to meet its goal of debt per capita ($700 in 1995 dollars) for the first time. On the other hand, the Committee commented on other factors to be considered in this decision including the unsettling effect such a dramatic change from the State's past practice of consistent issuance annually could have on the market and the less dramatic effect a year of no debt would have on the State's debt position. On balance, the strategy to forego a bond issuance in FY '01 and to fund the capital projects with cash is a reasonable one.

C. SHORT-TERM DEBT

The amount and duration of short-term borrowing is usually dependent upon two critical factors: a recurring revenue stream matching recurring expenditures (in other words, an ongoing balanced budget); and a healthy budget stabilization reserve, so that seasonal or economic dips in revenue as well as heavy expenditures that do not match up precisely with times of heavy revenue collection are offset by this reserve. Vermont has achieved these two standards to ensure little or no short-term borrowing, and it is expected that the General Assembly will continue to maintain balanced budgets and fully funded reserves.

II. INVESTING

A. LONG-TERM INVESTMENTS

The State Treasurer's Office administers the investment policies and strategies adopted by the Boards of the Vermont State Retirement System, the State Teachers' Retirement System of Vermont, and the Vermont Municipal Employees' Retirement System. The three systems had combined assets of nearly $2.5 billion on June 30, 2000 which represents an increase of 103.2% for the past five years and a 15.2% average annualized growth rate. A detailed statement of each plan's fiscal year 2000 assets including a comparison to fiscal year 1999 is attached as Appendix A.

In order to insulate the portfolios from short-term market fluctuations, the three pension systems employ diversified investment strategies, which enable each portfolio to weather the ups and downs of different asset classes. Each system's assets are invested in stocks, bonds and real estate with an additional small allocation to alternative investments, such as venture capital partnerships. These investment categories have imperfect correlations, so if one category is faltering, another may be doing exceedingly well. This strategy minimizes the effects of short-term volatility that occurs within each asset class. This strategy is totally different from market timing, where an investor tries to time precisely the ups and downs of various markets. In this strategy substantial losses can occur if the timing decision is wrong.

In fiscal year 2000, assets grew by 7.4% for the State Teachers' Retirement System of Vermont, 9.9% for the Vermont State Retirement System, and 8.8% for the Vermont Municipal Employees' Retirement System. Variations in asset growth among the three systems are dependent on many factors. Among them are cash flow requirements, differences in asset allocation and early retirement incentives.

The Table below displays the asset distribution of the three retirement funds:

Table 1

Asset Allocation of Three Retirement Funds
Quarter Ending June 30, 2000

Investment Category	Municipal	Teachers'	State
Domestic Equity	43%	44%	49%
Domestic Fixed Income	34%	12%	15%
International Equity	14%	18%	18%
Global Fixed Income	0%	17%	8%
Real Estate	6%	8%	8%
Other	3%	1%	2%

For the five years ended June 30, 2000, the median public retirement plan in the United States had an average annualized total return of 13.14%, compared with 16.32% for the Vermont State Retirement System, 15.39% for the Teachers' System and 15.75% for the Municipal Employees' System.

B. SHORT-TERM INVESTMENTS

The State Treasurer's Office manages the investment of the State's cash in its short-term investment program. The short-term portfolio earned over $11 million in interest income in fiscal year 2000 on average daily balances of $197 million. This computes to a yield of 5.53% for the year which is .3% higher than the average three-month treasury bill auction rate of 5.23%. The Treasurer's Office solicits offerings daily from the institutional trading desks of dozens of national and local brokers in order to achieve the maximum rate of return and diversification in the portfolio.

C. THE VERMONT TRUST INVESTMENT ACCOUNT

The 2000 Legislature authorized the establishment of an investment account administered by the State Treasurer for purposes of investing restricted funds with non-expendable principal balances.

The State Treasurer issued a Request for Proposals to investment managers in the State of Vermont and chose three firms to manage the fund: NL Capital Management, Inc. of Montpelier for fixed income and Hanson Investment Management, Inc. of Burlington and Prentiss Smith & Co. of Brattleboro for equity. At present the fund is 90% invested in fixed income in order to generate increased income for distribution during the early years. Over time, it is anticipated that the allocation to equity will grow to 40 to 50 percent, in order to generate additional capital appreciation.

The Trust Investment Account was funded in July 2000 with a principal balance of approximately $24 million, of which $17 million was allocated to the Tobacco Trust Fund, $6 million to the Higher Education Endowment Trust Fund, and the remainder to various smaller trust funds. For the six months ended December 31, 2000, the fund had a total return of 5.7% versus the return of the S&P 500 equity index of -9.2% and the Lehman Aggregate fixed income index of 5.4%. If these index returns are applied proportionately to the investment allocations of the trust account, the benchmark return is 3.9%.

D. VERMONT HIGHER EDUCATION TRUST FUND

The 1999 Legislature established a Vermont Higher Education Endowment Trust Fund and appropriated $6 million for the creation and management of the fund by the State Treasurer. On June 30, 2000, the fund had a market value of $6,377,094.53 for an annualized yield of 6.28%. In August of 2000, the State Treasurer authorized the equal distribution of 5% of the assets among the University of Vermont, the Vermont State Colleges and the Vermont Student Assistance Corporation. Each received $106,284.91 to be applied as non-loan financial aid to Vermont students attending Vermont post-secondary institutions.

In addition to the above disbursements from the fund, the Vermont Commission on Higher Education authorized the Treasurer to make available an additional $58,239.80 to be divided equally between the University of Vermont and the Vermont State Colleges for application to their respective permanent endowments, provided that it is matched on a two-to-one basis by external donations for endowment purposes by the end of fiscal year 2001.

E. TOBACCO LITIGATION SETTLEMENT FUND AND THE TOBACCO TRUST FUND

In November, 1998, Vermont was one of 46 states to enter into a settlement agreement with four major tobacco companies. The State's estimated share of settlement payments at the time was expected to total $806 million over the first 25 years of payment and an additional $156 million of strategic contribution payments to be paid between 2008 and 2017. The Legislature established a litigation settlement fund into which all proceeds of the settlement are to be deposited. Approximately $19 million of the first two years' receipts were reserved for long-term tobacco education and cessation programs of which $17 million was reserved in a trust fund established by the Legislature in the 2000 session. To date the State has received payments that total $41,181,773.90.

Payments due under the agreement are subject to a number of adjustment factors and downward adjustments of payments will occur if there is a decrease in the volume of cigarettes shipped by participating manufacturers in the United States. Preliminary calculations conducted by Price Waterhouse Coopers anticipated that a 2% downward adjustment due to volume declines would be applied to payments due in 2000. The payments made to the State in fiscal year 2000 represented a 13% discount of the payments originally anticipated. More recent projections indicate a volume adjustment of 15% for the year 2001 payments from the base year of 1997. This 15% adjustment was applied to the settlement payment due on January 10, 2001, and the State received $7,965,633.31.

It remains difficult to predict the amount of the future payments due from the tobacco settlement that will be received by the State. Tobacco sales are decreasing and litigation is ongoing around the country. A $145 billion judgment was awarded to a plaintiff in a Florida lawsuit this past year. Caution must be exercised when considering proposals to spend future settlement money. The settlement money should be placed in the Tobacco Trust Fund established by the Legislature last year in order to provide adequate cash flow in future years for tobacco prevention and health care purposes. If the State becomes accustomed to annual appropriations from the fund for other purposes, it will be difficult to maintain those spending levels, especially in fiscal years when general fund revenues are less plentiful. Vermont must not become addicted to tobacco money.

III. PRIVATE SCHOOL FINANCING

In the 1998 Capital Construction Act, the Legislature directed the State Treasurer to:

> study the feasibility of authorizing nonsectarian and nondiscriminatory independent schools accepting publicly tuitioned students and located in Vermont, including the Austine School for the Deaf and the Hard of Hearing in Brattleboro, to issue bonds for purchase by the Vermont Municipal Bond Bank.

One of the options presented by this study was enacted into law by the Legislature in FY '00. Act 121 established the Vermont Independent School Financing Authority with the purpose to assist independent schools with the issuance of capital bonds. The Authority consists of the directors of the Municipal Bond Bank and is authorized to borrow money and issue negotiable bonds and notes in order to make funds available at reduced interest costs to qualified independent schools. Any financing authorized by the proposed statute constitutes a general obligation of the educational institution and the institution must maintain at least an investment grade bond credit rating and pledge revenues at least equal to the annual debt service to the Authority. The bonds and notes issued by the Authority are general obligations payable out of the revenues or funds of the Authority and are neither obligations of the State nor backed by the State’s full faith and credit.

IV. RETIREMENT

A. OVERVIEW

The State Treasurer’s Office administers three statutory pension plans: the State Teachers' Retirement System of Vermont with 10,234 active and 3,647 retired members as of June 30, 2000; the Vermont State Retirement System with 7,386 active and 3,474 retired members; and the Vermont Municipal Employees’ Retirement System, with 4,789 active and 814 retired members. Both the State Teachers’ Retirement System of Vermont and the Vermont State Retirement System are funded by employee contributions as well as those made by the State. The Vermont Municipal Employees’ Retirement System involves no State money.

The Treasurer’s Office is seeking an additional position for a Program Services Clerk for fiscal year 2002 to assume primary responsibility for the daily operating procedures related to the two new defined contribution plans. The addition of DC plans for the State and Municipal Systems has added several new procedures that must be performed within the Retirement office. A new position is necessary to handle the additional workload to maintain high quality member services.

B. FUNDING OF THE RETIREMENT SYSTEM

Pursuant to Governmental Accounting Standards Board Statement No. 25, the funding status of the State and the Teachers’ Retirement Systems has improved (see Table 2), although the two largest systems remain actuarially underfunded. The General Assembly has appropriated less than the actuary's recommended contribution to the Teachers' System throughout the past decade. The higher than average investment returns of recent years have improved the funding levels of the systems.

Table 2

Percent Funded Using GASB Opinion No. 25

	State Teachers' Retirement System of Vermont	Vermont State Retirement System	Vermont Municipal Employees' Retirement System
Actuarial Value of Assets	$1,037,466,000	$895,151,000	$161,900,000
Actuarial Accrual Liability (AAL)	$1,174,087,000	$967,064,000	$138,697,000
Unfunded AAL (UAAL)	$136,621,000	$71,913,000	($23,203,000)
Funded Ratio	88.4%	92.6%	116.7%

A comparison of the funded status in recent years is contained in Chart 7.

Based upon the actuarial recommendation, the Treasurer has requested $21,965,322 in FY '02 for the State's contribution to the Teachers' Retirement System and a $9,599,472 contribution to the State Retirement System.

C. Deferred Compensation Program

The State Board of Trustees for the Vermont Retirement System administers a deferred compensation program that has been available since 1973 as a savings option for State employees, municipal employees, employees of agencies such as VSAC, VEDA and VHFA, and members of the General Assembly. A plan participant may defer up to $8,500 or 25% per year, whichever is less, of his or her annual compensation and invest that money in one or more of the 15 mutual funds offered in the plan. On June 30, 2000, the plan had 4,351 State participants and 154 local participants for a total of 4,505 participants. As of June 30, 2000, total assets in the plan were valued at $140 million. Contributions in the amount of $10.1 million were made to the plan by participating employees during fiscal year 2000. Because the deferred compensation plan qualifies as a section 457 plan under the Internal Revenue Code, the portion of salary that is deferred is not taxed at the time of deferral. The

Board of Trustees for the Vermont State Retirement System adopted a policy to waive fees for new enrollees in the plan after January 1, 2001 for the first full year of enrollment. This is one way to encourage participation in a plan that decreases taxable income during active employment and increases savings for retirement.

D. DEFINED CONTRIBUTION RETIREMENT PROGRAM

In 1998, the General Assembly offered active exempt State employees the option of remaining with their existing defined benefit plan or transferring their accrued benefits to a newly established defined contribution plan. Out of a pool of 806 eligible exempt employees, 349 (43%) elected to leave their State retirement defined benefit plan and transfer to the defined contribution plan whereby employees select from a menu of investment options. Exempt employees hired on or after January 1, 1999 are given the option of choosing between the two retirement plans.

In 1999 the defined contribution plan was extended to terminated, vested State members who were exempt employees at the time of separation from service. Of the 51 eligible vested members, 45 elected to transfer to the DC plan. The defined contribution plan has continued to grow, both in terms of total participants and actual dollars under investment. At June 30, 2000, the plan had 460 participants and total market value of $29,074,014.

In calendar year 2000, 125 new exempt employees entered the State's workforce. Thirty-nine (39), or 31%, chose the defined contribution plan; 44, or 35%, defaulted to the defined benefit plan and 42, or 34%, have not yet made an election.

Under the defined contribution plan, which is modeled after private sector 401(k) plans, employees contribute 2.85% of their annual salary to their individual accounts. The State makes a fixed contribution of 7% to each employee's account. Employees are responsible for making all investment decisions regarding contributions among investment options selected by the Treasurer. At retirement or termination, employees receive the amount of contributions in their account, plus investment earnings. The defined contribution plan provides portability for an increasingly mobile workforce. It also reduces the unfunded liability for the State because the State does not assume the liability of a future pension benefit.

The Vermont Municipal Employees' Retirement System was given statutory authority in 1999 to approve a defined contribution plan for its members. The Board implemented a defined contribution plan on July 1, 2000. The plan provides the employer municipality with the first option of deciding whether to offer a defined contribution plan to its employees. Once a municipality elects to offer the plan to all eligible employees or to specific employment groups, an individual employee has the choice to remain with the defined benefit plan or transfer to the new defined contribution plan. New employees of municipalities offering both a defined contribution plan and a defined benefit plan will have a choice of either plan. During the first year, 62 employers offered the plan to approximately 800 employees. Two hundred (200), or 25%, elected to transfer to the DC plan effective July 1, 2000.

Vermont is in the forefront of pension system reform. Although common in the private sector, few states offer this type of a plan. In those few similar circumstances where an option between a defined benefit and a defined contribution plan is offered, Vermont is a leader in the percentage of employees who elected to convert to the new plan. According to published reports, the 43% conversion rate for exempt State employees was one of the highest in the country when comparing similar types of defined benefit to defined contribution conversions in the public sector. The numbers speak to the success of the information program, given the almost even split between employees choosing to remain with the current program and those switching to the new plan.

The State's experience with the defined contribution plan offered to exempt employees shows a strong interest on the part of employees in such a plan. The benefits to the employee of portability, the freedom to develop an investment portfolio that meets individual needs, the ability to pass the money to one's heirs, and the potential for higher investment returns and higher benefits at retirement have proven attractive. The State also benefits from offering a defined contribution plan not only because it has no future liability for benefit payments for those who choose the plan, but because the plan presents an attractive recruitment benefit for those who may not desire to remain in public employment for the duration of their careers. Providing potential employees with the option to choose a plan that best suits their career goals makes the State more competitive with the private sector. Moreover, fewer current employees with longevity will feel tied to jobs where they have reached a career plateau solely because it makes no economic sense to leave due to the structure of the defined benefit plan.

To date, the Legislature has made the defined contribution option available only to exempt State employees and municipal employees. The State's classified work force and the State's teachers should be provided the same option. At the close of the 2000 legislative session, the Vermont State Employees Association (VSEA), the Vermont National Education Association (VT-NEA) and the State Treasurer agreed to meet over the summer and fall to explore the optimal characteristics of a defined contribution plan for those two employee groups. Consensus was reached that a defined contribution plan as an optional retirement plan, if properly designed, could be beneficial. Recommended characteristics of the plan include:

1. The same employer contribution rate of 7% that is provided to exempt employees;
2. Oversight of the plans by the retirement board for the respective groups;
3. A one year election window during which employees could choose between the defined benefit and defined contribution plans;
4. A significant educational component regarding the two plans;
5. Cost neutrality to the DB plan.

Discussion of the design of a defined contribution plan continues and the affected groups are examining a defined contribution option internally before taking a formal position. Further progress will be reported to the Legislature as it occurs.

E. Joint Special Retirement Study Committee

A Joint Special Retirement Study Committee was created by the 1999 Legislature to conduct a comprehensive review of issues related to the three retirement systems. The Committee consisted of four Senate members, four House members and the State Treasurer. The Committee issued its final report on January 15, 2000 and made several recommendations to the Legislature.

The Committee recommended that the General Assembly apply four principles when considering changes to the retirement systems. The first principle to be applied is that financial security in retirement should be viewed as three components---social security income, retirement benefits and personal savings. Second, the Committee recommended that benefits be allocated equitably among beneficiaries. Third, the Legislature was encouraged to view pension funding as a contemporary obligation and to adopt a goal of 100% funding of the systems. Finally, the Committee recommended adoption of the principle that pension funds should be invested prudently but not so conservatively that investment performance is severely limited.

The Committee also recommended that the 2000 Legislature consider adding flexibility to the retirement systems through a defined contribution plan or lump sum pay out option. As explained earlier, the Vermont NEA, VSEA and the Treasurer's Office are examining in detail a proposal to provide a defined contribution option to State employees and teachers.

Further, the Committee recommended an expansion of purchasing options that have no cost to the systems such as military service, approved leaves of absence, and air time. Under the "air time" provision, a member may purchase up to 5 years of additional service credit when the member has a minimum of 25 years of creditable service. The committee further recommended that death in service benefits be available to dependents; that the vesting period for teachers be reduced from 10 to 5 years; and that a minimum cost of living increase of 1% be enacted for both the teachers and State employees' systems. Each of these recommendations was considered and passed into law during the 2000 session.

Finally, the Committee recommended that the Legislature begin discussion of three issues: a reduction of benefit adjustments for early retirement from 6% to 3%; provision of a COLA adjustment for those who leave the system early but do not withdraw their contributions; and provision for a State funded match in the deferred compensation programs to encourage greater employee participation.

F. Legislative Studies

In Act 158, the General Assembly directed the State Treasurer to complete three reports pertaining to retirement issues.

1. Firefighters Inclusion in Group C of the State Employees' Retirement System

Section 27 of Act 158 directed the State Treasurer to report on the economic impact of providing firefighters currently employed by the State of Vermont with the option to be included in Group C of the State employees' retirement system. The full report is included in Appendix B. Several concerns with this proposal have been raised including the advisability of providing a member with the option of choosing membership in a particular group and the proposal to fund the cost with federal funds.

2. Military Service Credit

Section 28a of Act 158 directed the State Treasurer to conduct a comprehensive study of military service credit in the three retirement systems and to report findings and recommendations to the General Assembly. The Treasurer's full report is included as Appendix C. The report recommends that the Legislature consider a one-time payment to veteran's who were unable to take advantage of certain purchase and grant options; that a purchase option be made available to municipal employees; that a grant of service credit be provided for leaves of absence to serve in the military; and that the statute that provides for a purchase or grant of military service credit be amended so it is consistent with federal law.

3. Department of Social and Rehabilitation Services and State Hospital Employees

Section 29 of Act 158 directed the State Treasurer to submit a report that assesses the financial impact on the Vermont State Retirement System if employees of SRS who provide supervision and treatment services to juveniles in the community and employees of the Vermont State Hospital are provided retirement benefits and options equal to those received by employees of the Department of Corrections. The financial impact of this change is outlined in the full report included as Appendix D. It is recommended that the Legislature refrain from acting on a proposal that targets SRS employees alone. Other State employees, such as adult protective service workers, for example, may face similar stresses in their jobs and seek the enhanced benefit in future legislation. Identification of employees who should be considered for this benefit and development of clear criteria for consideration for the benefit should be completed. This would help to avoid future piecemeal, and costly, proposals by other discrete employee groups and provide a framework within which future requests for inclusion could be considered.

V. ABANDONED PROPERTY

The primary function of the Abandoned Property Division is to locate and return to a rightful owner property (i.e., cash, checks, stocks, bonds, bank accounts, contents of safe deposit boxes) that has been turned over to the State by companies and financial institutions that claim they are unable to locate these owners.

Currently, more than $12 million of unclaimed property is held by the State Treasurer. In fiscal year 2000, holders of unclaimed property turned over $2.2 million of property to the State and the Abandoned Property Division paid a total of $2.4 million in claims. According to the National Association of Unclaimed Property Administrators (NAUPA), this represents a 109.74% rate of return and is the highest in the nation. The average rate of return nationwide is 38.87%. NAUPA determines a state's rate of return as the ratio of the amount of money collected in a given year to the amount of money paid in claims in that same year. The money paid in claims represents the return of money received in prior fiscal years as well as in FY '00. Of the $2.2 million collected in FY '00, $977,324, or 44.91%, was returned to owners in the same year as it was reported. The average claim was $628.25 and the largest claim paid was $107,000.

There are several reasons for this success. For one thing, the Legislature has granted resources over the last few years to increase staffing and to upgrade our computers and software. Also, we have enlisted the help of town clerks in an effort to locate individuals. With increased staff we've been able to devote some time to tracking down people through telephone books, the internet, and other means, which have proven beneficial. In addition, the office has posted the names of owners of abandoned property on the internet where it is easier to search for a name. In fiscal year 2000, the Treasurer's Office was one of the first states to be linked via the internet to a central national website through which the public can more easily access the office's website. Users of the State's website now have the ability to download reporting and claim forms. A legislative change that shortened the time after which property is deemed abandoned (from seven years to five years) makes it easier to find owners. Reciprocity with other states in order to return abandoned property to the state in which the owner most recently lived has also proved effective in returning property to its rightful owner as quickly as possible.

VI. AUDIT COMPLIANCE

In fiscal year 1999, an Audit Compliance Division was created within the State Treasurer's Office. This Division conducts independent reviews of the diverse operations and controls within the office to determine whether acceptable policies and procedures are followed, established standards are met, and resources are used efficiently and economically in reaching the organization's objectives.

Last year, the Division made several minor recommendations to improve existing Abandoned Property controls. This year, in anticipation of a new accounting system for Abandoned Property, additional recommendations have been made to the accounting system review committee. These recommendations were made to ensure not only that adequate controls exist but that efficiencies in operation and financial reporting are incorporated into the system.

The Division has also assisted the Accounting Division in reviewing the more than 250 departmental cash accounts. A format for controlling these accounts has been implemented and additional financial disclosure has been prepared for the State’s Comprehensive Annual Financial Report (CAFR).

In addition, the Division has been actively involved in reviewing the work performed by the State’s contractor who provides the accounting for the State’s pension funds. Some adjusting entries were necessary to incorporate all the financial data on an accrual basis for the State’s CAFR.

VII. FINANCIAL MANAGEMENT

A. ELECTRONIC BANKING/PAYMENTS/TRANSFERS

The State Treasurer’s Office encourages electronic payments of such items as vendor payments, payroll, welfare and other benefits. Most State aid payments to municipalities are now handled electronically. In August 1999, the Department of Taxes began a program to receive tax payments electronically. Our goal continues to be to increase the proportion of financial transactions that occur electronically.

The Treasurer’s Office has encouraged State employees and retirees to authorize direct deposit of their paychecks and retirement checks. Direct deposit is a more efficient, less costly and safer method by which to transfer funds. In December of 2000, 77% of retired municipal employees, 84% of retired State employees, and 88% of retired teachers received their monthly benefit payments via direct deposit. This is an increase from the December 1999 percentages of 73%, 83%, and 86% respectively. Currently 6,358 State employees, or 72%, have their biweekly pay deposited directly to their bank accounts.

B. Interaction With the Auditor of Accounts' Office and Compliance With Audit Findings

Interaction with the Auditor of Accounts' office has proven essential to improvements in the State's financial reporting systems. The Auditor's office has offered financial reporting recommendations over the years that have proven helpful. In addition, every audit finding is taken seriously and, since the Treasurer's Office handles more than $4 billion of retirement and State funds, its Audit Compliance Division is used to ensure proper financial controls. The number of audit findings relating to the Treasurer's Office has declined significantly in recent years.

C. Act 60 Receipts

The Treasurer's Office monitors the receipt of payments mandated by Act 60 after the Departments of Education and Taxes have notified towns and school districts of their respective liabilities. In FY '00, all towns and school districts eventually made their Act 60 payments with the exception of the Town of Victory. Victory did not make its Act 60 payments due on December 1, 1999 and June 1, 2000. The State Treasurer, pursuant to his statutory authority, has withheld State payments due Victory to satisfy the Town's liability. The Vermont Tax Department has filed suit against the Town of Victory in an effort to obtain compliance with Act 60's requirements. Victory did not pay the latest installment due December 1, 2000.

To date, in addition to Victory, one school district and one unorganized town have not yet made their FY '00 Act 60 payment that was due on December 1, 2000. The Treasurer's Office is in the process of conferring with these entities to encourage compliance and calculating the interest on the late payments. As in the past, unresolved delinquencies will be referred to the Attorney General for collection.

VIII. Legislative Reporting Requirements

A. Brandon Training School

Section 23 of Act 62 (Capital Bill) of the Public Acts of 1995 specifies that the State Treasurer notify the chairs of the Senate and House Institutions committees upon receipt of monies from the sale of the Brandon Training School property as well as certain federal receipts associated with the Vermont Veterans Home. The State has received amounts due from the federal government for reimbursement of expenses associated with the Vermont Veterans Home, and has received $292,524 from sale of property belonging to the Brandon Training School.

B. McBride Principles

Act 50 of the Public Acts of 1989 specifies that the State Treasurer and the Retirement Boards compile a list of corporations that conduct business in Northern Ireland in which the State Treasurer and Retirement Boards have invested funds. This list is available to anyone who desires to examine it at the Retirement Division of the State Treasurer's Office.

C. Burma (Myanmar)

Act 13 of the Public Acts of 1999 specifies that the Treasurer shall implement the purposes of the Act by voting in favor of shareholder resolutions concerning an individual company's doing business with the government of Burma. In addition, the Treasurer shall separately notify the company that Vermont wishes to convey its grave concerns regarding the company's economic ties to the government of Burma. The Treasurer has complied and continues to comply with his obligation under this statute.

IX. Legislative Proposals for 2001

The Treasurer will recommend the following legislation to the 2001 General Assembly:

A. Credit Card Legislation

The Treasurer recommends that the Legislature consider a single statute giving all State agencies and departments the authority to accept credit card payments for fees, licenses, and other payments, rather than the piecemeal department by department approach used to date. The proposal would place oversight of the credit card program in the Treasurer's Office which would negotiate bank contracts on behalf of all the departments.

B. Military Installation Receipts

The Treasurer recommends an amendment to Section 557 of Title 1 of Vermont Statutes Annotated that will provide for the distribution of money, in compliance with federal law, received from the sale of forest products from U.S. military installations and U.S. Department of Transportation facilities in Vermont. The federal law provides that 40% of the net proceeds of these sales are to be distributed to the State, as the State Legislature proscribes, for the benefit of public schools and roads in the county in which the installation is located. The proposed amendment would add these proceeds to an existing statute that distributes the proceeds from the sale of products from national forests among the school districts in which the forest is located.

C. Retirement Issues

The State Treasurer will propose legislation that offers a defined contribution plan to teachers and State employees; a revised definition of "teacher" for the State Teachers' Retirement System of Vermont; and a clarification of last year's amendment to the State retirement system statute that opened up the Group C plan to certain law enforcement officers but may have inadvertently imposed a mandatory retirement age on elected sheriffs.